The ACOA
Trade ToolKit

Export Financing & Risk Management Services

Reference Booklet

Atlantic Canada Opportunities Agency

ACOA TRADE TOOLKIT

EXPORT FINANCING & RISK MANAGEMENT SERVICES

REFERENCE BOOKLET

INTRODUCTION

The ACOA Trade Toolkit Reference Booklet on Export Financing and Risk Management Services contains an overview on financing programs available to export ready SME's, the appropriate methods of payment as well as a comprehensive list of financial instruments and services available to minimize the risk of non payment.

This booklet was prepared by Business Advisory Services Inc.

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1.0 EXPORT FINANCING PROGRAMS & INSTRUMENTS

This section outlines the programs and instruments which are relative to the two primary areas namely, **capital goods** and **goods & services.**

1.1 Export financing in support of capital goods exports

1.1.1 Buyer credits

Buyer credits are financing arrangements where the lender provides funds directly to the borrower, or to the borrower's order. For borrower credits tied to exports, the lender disburses funds on behalf of the buyer/ borrower directly to the exporter according to the terms of the commercial contract. **Buyer credits in terms of international trade tend to be relatively large in value.** This is due to high transaction costs incurred in setting up international financing agreements, which make smaller arrangements unattractive. Buyer credits offered in support of Canadian capital goods and services exports also tend to be without recourse to the Canadian exporter. As such, the availability of buyer credit financing for a particular project is dependent upon the credit worthiness of the foreign buyer and the country involved. Buyer credits used to support capital goods and services exports include **direct loans** and **allocations under lines of credit.**

Buyer credits
(Financing arrangements)
- *Lender disburses funds on behalf of buyer directly to exporter.*
- *Large in value due to high transaction costs.*
- *Tend to be without recourse to Canadian exporter.*
- *Availability dependent on credit worthiness of buyer and foreign country.*

Include:
Direct loans
- *Target larger capital goods transactions*
- *Complex loan agreements*
- *Not suited for SME's*

Line of credit allocation
- *Established between Canadian lender & foreign bank*
- *Smaller capital goods & services exports*
- *$50,000 - $5 million*

Direct loans are well suited to financing large, distinct capital goods and services export transactions involving complex international loan agreements. Accordingly, this financing instrument will not normally be relative to the SME market exporter.

A **line of credit** allocation is often used in support of Canadian capital goods and services exports. In this financing arrangement, a general line of credit is negotiated between a Canadian lender and a foreign bank, which provides umbrella financing for approved exports. The Canadian lender needs only to determine the credit worthiness of an established foreign bank that it relies upon for repayment, while the foreign bank is able to use its local market strength to market the line of credit financing and on-lend the funds to local, credit worthy buyers of Canadian capital goods and services. Line of credit allocations are especially useful for smaller capital goods and services exports with contract values of $ 50,000 to $ 5 million.

1.1.2 Supplier credits

Supplier credits are financing arrangements in which the lender provides funds directly to the exporter, who in turn offers medium-term financing support to its foreign buyer of capital goods and services. Typically, supplier credit financing is effected by the lender purchasing the foreign buyer's promissory note from the exporter. This use of promissory notes allows the parties to the financing arrangement to avoid the costs and time involved in negotiating and securing an international loan agreement. This makes supplier credits particularly attractive to smaller exports where high transaction and financing costs can quickly cause an export sales transaction to become uncompetitive in cost. Most supplier credits will be in the range of $250,000 to $1 million, although transactions of $ 2-3 million are not uncommon.

Supplier Credits

- *Lender provides funds directly to the exporter*
- *Exporter provides medium term financing to foreign customer*
- *Lender purchases promissory note from exporter*
- *Attractive for smaller exports (lower cost)*
- *$ 250,000 - $ 1 million range*

Note purchase agreement financing involves the lender purchasing promissory notes issued by the foreign buyer to the Canadian exporter. **Forfaiting** is a special case of note purchase financing, which came into existence to meet the needs for non-recourse, medium-term financing, for sales by Western European exporters to Eastern European, state-owned buyers. Since then, forfaiting has taken hold as an alternative source of medium-term, fixed rate financing

Forfaiting

- *Supplier credit financing without recourse to the exporter*
- *Available from the EDC and Royal Bank of Canada*
- *Converts medium term credit sales to cash sales*
- *Provides fixed rate financing to foreign buyer*
- *Requires a promissory note for each repayment date*
- *Quoted at a discount rate basis*

for capital goods and services, which is used by exporters worldwide to convert medium-term credit sales to cash sales. In Canada, forfaiting services are offered by the Export Development Corporation (EDC) and the Royal Bank of Canada. The most distinguishing feature of forfaiting is that it is supplier credit financing without recourse to the exporter. In essence, the term “forfaiting” is an English derivative of the French “forfait” which means “ to give up the right” of recourse to the endorser of the notes (the exporter in this case). As notes purchased in forfaiting transactions are without recourse to the exporter, they must carry the “avail” of a commercial or state bank that establishes the notes as an unconditional obligation of the availing bank.

There are several other features of forfaiting that distinguish it from standard note purchase agreements. **First**, forfaiting provides only fixed rate financing to the foreign buyer, whereas standardized note purchase agreements can provide either fixed or floating rate financing. **Second**, forfaiting requires a separate promissory note for each “repayment” date of principal and interest set out in the loan amortization schedule. As such, if the export transaction calls for 6% fixed rate, five year financing with semi-annual payments commencing 6 months after delivery of the capital goods and services, the exporter will have to secure 10 promissory notes for forfaiting. Each note will typically be the aggregate of the principal repayment due on that repayment date plus interest on the outstanding balance of the loan, although blended principal and interest repayments can also be arranged. The forfaiter will then purchase, at a discount, each of the notes from the exporter, having deducted interest due on each note from the point of discounting until the maturity of the note. In determining the “final” maturity date, the forfaiter adjusts the total tenure of the note by adding one or two additional days if the note falls due on a Sunday or a Saturday as well as a number of days of grace to each maturity. **Third**, forfaiting financing is quoted on a discount rate basis that, due to the deduction of interest in advance, results in a higher effective yield to the forfaiter than would an identical interest rate quote. This difference between the discount rate quoted and the effective interest rate increases substantially as the financing term lengthens.

1.1.3 Leasing

Leasing provides for the transfer of goods to a foreign buyer without the transfer of title to the goods. In essence, the foreign buyer does not buy the goods at all but rather obtains the use of the goods by agreeing to pay a series of (usually) monthly lease payments. This exchange of goods for a series of payments is not unlike a typical capital goods financing arrangement between a Canadian exporter and a foreign buyer. There are primarily two types of leases namely, operating and financial.

Leasing

2 *Foreign buyer obtains access to goods*

Two types:

Operating lease
- *rental agreement*
- *provides the use of functional equipment*

Financial lease
- *manufacturer sells to lender or leasing house & ownership transfers to lessee at end of term*

Includes:
Cross border- Canadian manufacturer sells equipment to Canadian leasing company who leases to foreign customer.
International- Manufacturer exports equipment directly to foreign leasing company.

Operating leases involve a true rental agreement where the lessor (the Canadian exporter) provides functional equipment for the use of the lessee (foreign customer).

Financial leasing normally involves the Canadian manufacturer selling the equipment to a lender (leasing house) that will then lease the equipment to the foreign lessee for a period commensurate with the expected life of the equipment. Ownership of the equipment is usually transferred to the lessee at the end of the term for a nominal sum. An enhancement of the financial lease is the leveraged lease that involves a lender in addition to the lessor. With leveraged leasing, the lessor provides a portion of the value of the equipment as equity (for instance 25%) and finances the remaining portion (75%), using the equipment as collateral for the loan.

Cross border and international leasing both serve as a financial mechanism for Canadian exports of capital equipment. In cross border leasing, upon finding a foreign customer for its equipment, the manufacturer sells the equipment to a Canadian leasing company that, in turn, leases the equipment to the foreign customer. In contrast, international leasing involves the manufacturer directly exporting the equipment to a leasing company in the foreign customer's country.

1.2 *Export financing in support of goods and services available to SME's in Atlantic Canada and relative instruments :*

1.2.1 *Foreign buyers*

Cash in advance for goods or services to be exported is the most secure option. Unfortunately, few foreign buyers are willing to pay full cash in advance. On occasion, a buyer will provide a portion of the cost as a down payment. For services, a partial payment may be made upon signing a contract, after which progress payments are matched to deliverables.

Foreign buyers

Cash in advance
- *most secure option*
- *full cash in advance (ideally)*
- *partial payment in advance (occasionally)*
- *progress payments matched to deliverables*

1.2.2 *Conventional lending institutions (i.e. banks, credit unions & trust companies)*

CONVENTIONAL LENDING INSTITUTIONS

OPERATING LINE OF CREDIT	TERM LOANS	GOVERNMENT GUARANTEED LOANS
Exporter establishes a line of credit with a domestic bank. Domestic bank usually requires that foreign accounts receivable be insured. This can be accomplished by obtaining insurance from the EDC.	Used to finance capital costs associated with expansion requirements for entry into the export trade. Terms and conditions vary according to the particular transaction.	Federal Government loan program available through the Small Business Loans Act. Non-operating purposes similar to term loans. Only "for-profit" businesses are eligible; farming is excluded. Maximum outstanding loans per borrower $ 250,000.

Operating line of credit : Canadian exporters traditionally will have lines of credit in place with their bankers to finance accounts receivable and inventory. However, unless the exporter is highly capitalized, banks usually will require additional security to protect the pledged accounts receivable against foreign risk. This additional security is available from the Export Development Corporation in the form of "EDC Insurance" . This insurance policy can be assigned to the lending institution and covers the exporter against losses resulting from commercial risks if the buyer :

- becomes insolvent

- refuses to pay (default)
- refuses to accept the goods shipped (repudiation)
- unilaterally terminates the contract

EDC Insurance also covers a wide range of political losses, such as:

- the buyer is unable to access hard currency; the exporter is unable to take the hard currency out of the buyer's country.
- the Canadian export permit is canceled or the buyer's country cancels an import permit.
- war, revolution or insurrection in the buyer's country or between two or more countries.

It must be noted that the EDC Insurance will contain certain conditions which would limit coverage. A common condition is that insurance is not available in the event the exporter is in default of the contract.

Term loans : Term loans are available to qualifying enterprises to finance the capital costs associated with expansion into the export trade. Terms and conditions will vary according to each project and will depend on the nature of assets financed and the financial strength of the enterprise.

Government Guaranteed Loans : The most common and widely utilized product in this category is the Business Improvement Loan which is provided by approved lenders for small business development, according to the Small Business Loans Act. Its basic characteristics are similar to term loans outlined above, however in certain circumstances, enterprises may not qualify to access traditional term lending products from financial institutions. Business Improvement Loans are joint efforts between lenders and the Federal Government whereby any losses incurred from the loans are shared between both parties. Eligibility requires that the applicant business be a for-profit business, including professional operations, but excluding farming, charitable and religious organizations. Typical financing is for non operating purposes.

1.2.3 Federal and provincial government departments/ agencies:

Business Development Bank of Canada (BDC)	Products offered: C Term loans C Venture loans C Working capital loans C Working capital for exporter's loans (Max. $250,000)
Export Development Corporation (EDC)	Services available: C Insurance (Foreign Investment & Export Credit) C Financing (Lease, Pre-shipment, & Concessional) C Direct loans (up to 85% of exports/15% local costs) C Lines of credit for smaller exports ($50,000-$5 million) C Note purchasing & forfaiting for smaller exports $1-$5 million
Program for Export Market Development (PEMD)	C Provides assistance prior to contract stage C Conditional repayable assistance available C Applicants must be export ready & registered with Win Exports C Market Development Strategies Program offers 50/50 cost sharing C Other services include assistance in foreign bid preparation, new to exporting international marketing, and Trade Association Activities
Canadian Commercial Corporation (CCC)	C Crown Corporation- acts as international trade facilitator and prime contractor for sale of Canadian goods and services C Provides guarantee of performance C Can assist exporters win contracts and assist with financial requirements.
Canadian International Development Agency (CIDA)	Has two direct assistance programs which are of most benefit to SME's in Atlantic Canada : C Bilateral -Solicits bids from qualified Canadian exporters -Disburses funds directly to Canadian exporters C Partnership - The Industrial Co-operation Program component directs financial support into investment, professional services and specialized activities and is repayable if it leads to profitable operations
Provincial government departments and agencies (Atlantic).	Specific programs not in place, however, financial support could be available for companies entering into export markets.
Atlantic Canada Opportunities Agency (ACOA)	C Assistance available through Business Development Program (50%) for start up, expansion, and modernization; 75% for operation costs such as studies, marketing training & Quality Assurance C Business support in the area of trade development & marketing

Business Development Bank of Canada (BDC) : The BCD offers a range of innovative financial services to meet the special needs of enterprises at all stages of the exporting process, from research and development to production and shipment. Products available include term loans, working capital loans and venture loans. This agency offers a "Working Capital for Exporters" loan to provide the important additional pre-shipment financing needed to effectively exploit export potential. Loans of up to a maximum of $250,000 are available and principal payments may not be required in the first year.

Export Development Corporation (EDC) : The EDC, a Federal Crown Corporation, is Canada's Export Credit Agency (ECA) and supports Canadian capital goods and services exports by providing export credit financing and guarantees that are competitive with that offered by other ECA's. It provides a range of financial services to Canadian exporters, including :

- Export credit insurance covering short and medium term credits.
- Export financing programs providing medium and long term export financing to foreign buyers of Canadian goods and services:

  Direct loans are used by the EDC to finance up to 85% of the value of eligible Canadian goods and services exports with an additional 15% financing occasionally available to help finance local costs incurred in overseas projects. The EDC offers fixed and floating rate financing, primarily in U.S. and Canadian dollars.

  Lines of credit are used extensively by the EDC to finance smaller exports typically valued between $50,000 and $5 million. These lines of credit are negotiated by the EDC with commercial and state development banks to finance a collection of export sales by Canadian firms to a particular region.

  Note purchasing and forfaiting facilities were introduced by the EDC in the early 1980's to meet a perceived need for supplier credit financing. These facilities can be used to finance smaller sales of Canadian capital goods and services, typically valued at less than $5 million and having a repayment term under 5 years. However, relatively little use has been made of these facilities as the EDC's lines of credit are used to finance most of the smaller exports that could be financed with supplier credits.

The EDC's broadened legislative powers now allow the corporation to support export sales with lease financing, pre-shipment financing, minority equity participations, and concessional financing. Leasing is offered in those transactions where normal loan arrangements are not practical, or where the buyer prefers a leasing arrangement.

- Performance related guarantees and insurance providing coverage for exporters and financial institutions against calls made on various performance bonds and obligations normally issued by banks or surety companies.
- Foreign investment insurance providing political risk protection for new Canadian investments abroad. (Threshold sales annually $5 million +).
- Specialized services are available for smaller exporters including new entrants to the export market.

The non funding services outlined above may be utilized in order to obtain funding from other lending institutions.

Program for Export Market Development (PEMD) : The PEMD is the Federal Government's primary international business development program providing assistance prior to the contract stage as well as conditional repayable assistance in support of a variety of activities to help Canadian exporters expand into export markets.

Contributions subject to repayment are repayable based upon incremental export sales or contracts obtained in the target market. Preference is given to companies with annual sales greater than $250,000 and less than $10 million, and/or with less than 100 employees for a firm in the manufacturing sector and 50 employees in the service industry. Applicants must be export-ready Canadian companies, and registered with WIN Exports. The principal element of the program, Market Development Strategies (MDS), provides cost shared (50/50) assistance on the basis of a company's one or two year international marketing plan for activities such as:

- market identification visits
- trade fairs

- product testing for market certification
- legal fees for marketing agreements abroad
- transportation costs for offshore company trainees
- product demonstration costs
- other costs necessary to execute a marketing plan.

The Capital Projects Bidding (CPB) element is designed to assist Canadian manufacturing, engineering, construction, architecture and management consulting firms in bid or proposal preparation against international competition for major capital projects outside Canada. The bid value to the applicant must be greater than $1 million . The PEMD contribution for MDS and CPB is a minimum of $5,000 and a maximum of $50,000.

The New to Exporting Companies component of the PEMD recognizes that a significant number of Canadian companies have little export experience. A maximum contribution of $7,500 is available to such companies to either visit a potential market or participate in an international trade fair.

The Trade Association Activities program is dedicated to the agri-food sector and provides financial assistance on a cost shared basis to national agri-food associations engaged in export market development.

The various elements of the PEMD are delivered by International Trade Centres (ITC's), regional development agencies and some provincial governments across Canada.

Canadian Commercial Corporation (CCC) : The CCC is a Crown corporation that reports to the Minister of International Trade. It acts as an international trade facilitator and as a prime contractor for the sale of Canadian goods and services to foreign governments, international agencies, and other foreign buyers. As a Crown corporation, the CCC's participation in an export sale constitutes a commitment of the Government of Canada that the contract will be performed. This guarantee of performance to foreign buyers can be especially important to Canadian firms that have not yet established an export sales track record.

The CCC guarantees performance to foreign buyers by taking on the role of prime contractor with the foreign buyer. As such, the CCC purchases goods and services from Canadian suppliers and sells them to customers abroad using back-to-back contracts. The CCC's role as prime contractor occurs as a result of foreign regulations (as is the case for sales to U.S. Department of Defense), or in response to a request from a foreign buyer or Canadian exporters that the CCC serve as a principal in their export transaction.

The CCC can help Canadian exporters win and carry out export contracts and assist with the financial requirements by:

- Using the CCC's contractual support as assurance to the foreign buyer that the Canadian exporter is financially and technically capable of performing to bid specifications, contract terms, and manufacturer's warranties.
- Allowing for more competitive pricing by eliminating (in some cases) the need for documentation, bonds and guarantees, or by negotiating more favorable payment, acceptance and holdback terms.
- Advising on bid preparation, international tendering processes, payment terms and conditions, contacts, sources of assistance, cultural issues and business practices, as well as the legal and regulatory characteristics of each target market.

Canadian International Development Agency (CIDA) : Official development assistance or aid financing is provided by various national, multilateral, and regional aid organizations to accomplish social and economic development objectives. These objectives include the provision of goods and services related to infrastructure development, educational assistance, and food aid in developing countries. Fulfilling these objectives requires the supply of goods and services from donor nations resulting in an export market valued in the tens of billions of dollars each year.

Canada is an active participant in official worldwide aid assistance and contributes hundreds of millions of dollars annually. Most of these funds are channeled through CIDA to support the agency's own international aid programs (primarily, its bilateral, multilateral, and partnership programs).

Most of the aid financing provided is "tied" to the donor nation. Participation in CIDA's direct assistance programs is mostly limited to Canadian firms while participation in the aid programs of the multilateral organizations is usually limited to member country businesses. As Canada is a member country of the World Bank Group, the Asian, Inter-American, and Caribbean Development Banks, as well as the European Bank for Reconstruction and Development, the **procurement activities of these agencies present substantial export opportunities for Canadian enterprises.**

CIDA channels most of its aid financing through its bilateral, multilateral, partnership and scholarship programs. The bilateral and partnership programs are the two which would be of benefit to SME's in Atlantic Canada.

The bilateral program is the agency's largest and accounts for about 40% of Canadian international assistance. The program provides assistance to developing countries in accordance with bilateral agreements signed by Canada and the developing country. Under the terms of these agreements, the developing country advises Canada of its wish to use the bilateral support to carry out specific development projects. CIDA then solicits bids from Canadian exporters qualified to provide the goods and services necessary to complete the development project. Funds provided under the bilateral program are then disbursed directly by CIDA to the Canadian exporter according to the contract entered into between CIDA and the exporter. Contract size varies substantially for goods and services supplied under the bilateral program, with most contracts between $1 million and $25 million.

The partnership program accounts for about 12% of Canada's international assistance, and is comprised mostly (75%) of funding for non government organizations and non government institutions carrying out international development projects. The Industrial Co-operation Program (INC) makes up the remaining 25% of the partnership program . The INC encourages linkages between Canada's private sector and the private sector in developing countries by sharing the risks and costs of pursuing long-term business opportunities in developing countries. The INC's financing support is directed into three program areas: investment, professional services, and specialized activities. It is also repayable if the support provided leads to ongoing, profitable operations.

The investment program assists eligible Canadian companies (mainly manufacturers) conducting feasibility studies on long term co-operation agreements with developing country businesses. It may also pay certain costs when a joint venture is set up with entrepreneurs in a developing country. Investment-oriented projects may qualify to receive viability study support up to $100,000 to develop a market analysis; an environmental impact assessment; a gender analysis and plan to fully integrate women into the project; a training plan; a business plan, and obtain the authorities' approval. They may also qualify for project support up to $500,000 to implement a training program, environmental management plan, and integration of women plan, as well as to cover start up costs.

The professional services program assists eligible organizations (mainly consulting firms, financial institutions, and business associations) conducting studies and providing professional guidance and advice to potential clients in developing countries related to capital projects. Assistance is available for capital project preliminary studies (about $350,000), capital project detailed studies (about $500,000), and capital project support (about $500,000).

The specialized activities program supports other activities that could have a major developmental and economic impact on developing countries. They include the Canada-China Technology Co-Operation Support Program, seminars, missions, technology transfer exhibitions, specialized training institutes, CIDA's Trust Fund for International Finance Co-operation (IFC), Canada Trade Facilitation Office, and the Canadian Fund for Local Initiatives.

Atlantic Canada provincial government departments/agencies : Specific programs are not in place with the provinces to promote export trade. However, each province offers financial support where an economic benefit would be available. Such financial assistance for companies entering into export markets would, for example, support trade shows, trade missions, and promotional material.

<u>Atlantic Canada Opportunities Agency (ACOA) :</u> ACOA's Business Development Program provides assistance to SME's in Atlantic Canada to start up, expand, modernize and become more competitive. This assistance may cover up to a maximum of 50% of related costs such as equipment, leasehold improvements, working capital and construction. It may also cover up to 75% of operation costs such as studies, marketing, training and quality assurance.

In addition to the financing component, ACOA provides valuable business support in the area of trade development and marketing. ACOA has taken a significant role in Trade Team Canada which was developed in early 1995. Its role in international trade involves providing guidance and education support to potential and export ready enterprises throughout the process.

1.2.4 Other non-conventional sources:

Northstar Trade Finance Inc. (Northstar) : Northstar offers a blend of official export credit and private sector loan support for eligible Canadian exporters doing business with credit worthy foreign buyers. Northstar was established with the assistance of both the federal and provincial government agencies, and the private sector through Dalhousie Financial Corporation and the Bank of Montreal. The company targets its support to small and medium-sized exporters and finances export sales valued at $100,000 to $5 million, with repayment terms of one to five years. The company lends directly to the foreign buyer receiving the Canadian goods and services, and secures its foreign receivable with EDC export credit insurance.

NORTHSTAR TRADE FINANCE INC.

- *offers blend of official export credit and private sector loan support*
- *targets support to SME's*
- *finances export sales of $ 100,000 - $5 million / repayable 1-5 yr. terms*
- *lends directly to foreign buyer & secures foreign receivables with EDC export credit insurance*

Financing plans :
Term Finance -
Fixed rate medium term loans to foreign buyers.

Floor plan -
Direct loans to foreign distributors of Canadian products/exporter paid directly.

Northstar offers two distinctive products, namely, "Term Finance" and "Floor Plan Financing". Northstar's Term Finance product provides fixed rate, medium-term loans to foreign buyers of eligible Canadian exports. Northstar's Floor Plan Finance product provides direct loans to foreign distributors of Canadian products to finance the products until their sale to an end user, or for one year from delivery, whichever occurs first. Northstar secures its loans by registering security interests in the goods being sold and EDC Insurance. The Canadian exporter is paid directly by Northstar, usually upon shipment of the goods, so is able to satisfy both the foreign buyers' need for financing and its own need for a cash sale.

Regional Development Banks (RDB's) : The RDB's of most interest to Canadian exporters are the Asian Development Bank, the African Development Bank, the Inter-American Development Bank, the Caribbean Development Bank, and the European Bank for Reconstruction and Development. Canadian exporters are qualified suppliers for projects supported by those banks, as Canada is a contributing member country to each one.

Exporters seeking to do business with the RDB's must contact the International Finance Division of the Department of Foreign Affairs and International Trade in Ottawa, the resident Canadian Executive Director of the RDB, and Canadian embassy contacts serving Canadian exporters doing business with the RDB's in order to determine the individual requirements of each bank.

2.0 PAYMENT DELIVERY SYSTEMS

For SME exporters in Atlantic Canada there are primarily four main options in negotiating a sale and getting paid. These are listed in order of risk beginning with the least risky.

- **Payment in advance.** This is the safest option because goods are not shipped until payment is received. However, it is obvious this option may be difficult to negotiate with foreign buyers, but nevertheless should be considered.

> **Payment in advance**
>
> - *goods are not shipped until payment is received*

- **Documentary letters of credit.** This method is also referred to as a documentary credit and is the same thing as a letter of credit which is the next best thing to payment in advance. A bank undertakes to make payment on the buyer's behalf provided the stipulated documents are presented and that terms and conditions of the letter of credit are strictly complied with. Letters of credit are a widely used and effective way of minimizing the risks of foreign sales. There are four types of letters of credit namely; Confirmed Sight, Unconfirmed Sight, Confirmed Term, and Unconfirmed Term.

> **Documentary letters of credit**
>
> - *minimizes risk of foreign sales*
> - *bank undertakes to make payment on buyer's behalf provided the stipulated documents are presented and terms and conditions of the letter of credit are strictly complied with*

- **Documentary collections.** This is an alternative to letters of credit that offers **some** protection to both the buyer and the seller. In this case, the bank acts as the exporter's agent in collecting payment from the importer and controls the flow of documents required to obtain the goods. It is noted that the bank acts only as agent in a documentary collection; it makes no undertaking to pay the seller. Collecting internationally is never easy and the exporter should have the confidence in the buyer and its ability to pay. Documentary collections may be payable after shipment (sight) or upon maturity or discounting of an accepted draft (term).

> **Documentary collections**
>
> - *offers some protection to both buyer and seller*
> - *bank acts as exporter's agent only in collecting payment & controls the flow of documents with no undertaking to pay the seller*
> - *may be payable after shipment, upon maturity or discounting of an accepted draft*

C **Open Account.** This is the most risky option for the exporter as goods are shipped before payment is received but is frequently used in well established relationships. There is no direct involvement by a bank when using this option.

Open account

- *most risky*
- *goods are shipped before payment is received*
- *frequently used in well established relationships*

3.0 MANAGING EXPORT FINANCING RISK

3.1 Areas of potential risk

Expansion into the export market entails risk not normally encountered in domestic trade. The following are areas of risk normally encountered in the export trade:

- **Foreign buyer risk.** This entails situations where the buyer may become insolvent, default on the contract, refuse the goods or attempt to cancel the contract.
- **Foreign exchange risk.** The possibility of loss from adverse movements in the foreign exchange rate is an ever present risk.
- **Country risk.** From time to time, import and export restrictions are imposed without ample notice. Currency inconvertibility or blockage of payments can also occur causing losses and cash flow problems for exporters. This problem occurs as a result of a shortage of foreign exchange in the home country of the foreign buyer. Lastly, the possibility of war, revolution and insurrection represent significant risks for exporters.
- **Performance risk.** Wrongful calls on performance result in losses and cash flow problems.

3.2 Services and instruments available to safeguard against non-payment

Overview:

Transferring export credit risk involves shifting the risks of non payment of export receivables from the exporter to an insurer or a bank. For Canadian exporters, this can be done by purchasing **export credit insurance** or by **discounting export receivables** without recourse at a commercial bank offering export receivables discounting services. Alternatively, if all considerations in the transaction warrant, an exporter may consider **self-insurance** of export credit risks. Generally the latter will not be appropriate for SME's in Atlantic Canada unless the exporter's resource base, diversity of markets, volume of export sales, accuracy of loss forecasting, and financial standing are all sufficient to warrant same.

3.2.1 Export credit insurance

Export credit insurance protects exporters against non-payment of export receivables. Key factors in the decision to purchase include the risks covered, amount of risk sharing, the premiums, and services offered by the insurer. In Canada, most export credit insurance is underwritten by the Export Development Corporation (EDC), although private export credit insurers are becoming increasingly active in the market.

3.2.2 Services available from the Export Development Corporation

The EDC's insurance programs include Foreign Investment Insurance, Global Comprehensive Coverage (Shipments & Contracts), Canadian Receivables Coverage, Contract Bond Insurance, and Specific Transaction Insurance.

Foreign Investment Insurance (FII) protects Canadian firms making foreign direct investments against political risks for up to 15 years. Three types of political risk are covered: **transfer difficulties** where the Canadian firm is unable to repatriate its earnings; **expropriation of the direct foreign investment** by the host country; and **war or insurrection** that causes loss to the foreign direct investment. The FII covers a variety of investments including equity, loans, loan guarantees, assets or equipment, and service contracts. Costs of the FII include a handling fee, yearly insurance premiums for coverage, and standby fees for additional coverage contracted under the policy.

Global Comprehensive Coverage protects Canadian exporters against most foreign buyer and country risks that could result in non-payment of export receivables. Risks covered under the shipment's policy include:

- Insolvency or default of the foreign buyer.
- Refusal of the goods by the foreign customer provided the exporter has met the contract terms.
- Payment delays caused by a blockage of funds or transfer difficulties.
- War or hostilities in the customer's country or between two or more other countries.
- Cancellation or non-renewal of export or import permits.

Exporters can also be protected against contract cancellation before the shipment of goods by choosing the "Contracts" policy option.

Canadian Receivables Coverage offered by the EDC enables exporters to avoid domestic losses that could impact on the exporter's ability to stay in, or enter, export markets and to increase the exporter's leverage at its commercial bank. In this latter regard, assigning the EDC's insurance on the firm's domestic receivables to a lending bank usually allows the exporter to qualify for a larger line of credit. Exporters can choose to exclude domestic sales to federal, provincial, and municipal governments from their domestic receivables coverage.

Contract Bond Insurance : The EDC offers three different performance security products to protect against loses from a foreign buyer's call on a bond : Performance Security Insurance; Performance Security Guarantees (for bank issued letters of guarantee); and support to surety companies posting security bonds for Canadian exporters.

- Performance Security Insurance covers the Canadian exporter against 90% of its losses from a wrongful call of its performance bond or if its bond is called as a result of certain events outside the exporter's control.
- Performance Security Guarantee covers the commercial bank issuing the performance guarantee against 100% of the bank's loss on rightful calls or wrongful calls removing the risk of non-reimbursement to the bank in the event of a call of the performance guarantee. This allows the bank to issue its performance guarantee without tying up the financial resources of the exporter.
- EDC support to surety companies includes insurance to cover 85% of the surety company's loss caused by the exporter's non-performance (rightful calls only) and is primarily for, but not necessarily limited to, export contracts within North America.

Specific Transaction Insurance covers larger individual transactions against foreign buyer and country risks. This policy provides for a considerable tailoring of coverage, since large export transactions often involve multiple suppliers and considerable pre-shipment risk.

3.3 Discounting export receivables

Export receivables discounting protects exporters against non-payment of export receivables and foreign exchange risk, plus provides an immediate cash flow from export sales. With export receivables discounting, the exporter sells its export receivables to its commercial bank on a non-recourse basis. The non-recourse feature transfers the risks of non payment due to buyer insolvency.

3.4 Other support services available from Canadian Commercial Corporation

In addition to the services offered by the EDC, **performance risk management services** are available from the **Canadian Commercial Corporation (CCC).** The CCC is a crown corporation that reports to the Minister of International Trade. Its performance risk management services include:

- Advising Canadian exporters about invitations to bid received from foreign governments, international agencies and other foreign buyers.
- Evaluating the technical and financial aspects of product, service or project export proposals.
- Reviewing the technical and financial capability of Canadian exporters for specific transactions.
- Participating in negotiations with foreign buyers.
- Executing prime and back-to-back contracts.
- Following through on all aspects of the export sale, including contract management, inspection and acceptance, shipping services, paying Canadian suppliers, and collecting from foreign buyers.
- Assisting in dispute resolution between the Canadian supplier and the foreign buyer.